

ARTHUR ANDERSEN LLP

MISSOURI LOTTERY

FINANCIAL STATEMENTS AS OF
JUNE 30, 1998 AND 1997
TOGETHER WITH AUDITORS' REPORT

ARTHUR ANDERSEN LLP

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Missouri Lottery Commission:

We have audited the accompanying balance sheets of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1998 and 1997, and the related statements of revenues, expenditures and retained earnings, cash flows and changes in grand prize winners trust account for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1998 and 1997, and the results of operations, cash flows and changes in grand prize winners trust account for the years then ended in conformity with generally accepted accounting principles.

Arthur Andersen LLP

St. Louis, Missouri,
October 2, 1998

MISSOURI LOTTERY

BALANCE SHEETS AS OF JUNE 30, 1998 AND 1997

	<u>1998</u>	<u>1997</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 19,208,728	\$ 15,281,454
Accounts receivable, net	21,052,905	18,065,213
Ticket inventories	<u>313,241</u>	<u>389,126</u>
Total current assets	40,574,874	33,735,793
PROPERTY AND EQUIPMENT, net	<u>6,442,016</u>	<u>7,079,673</u>
Total assets	<u><u>\$ 47,016,890</u></u>	<u><u>\$ 40,815,466</u></u>
 <u>LIABILITIES AND RETAINED EARNINGS</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 4,888,813	\$ 6,493,473
Due to Lottery Proceeds Fund	5,148,396	2,251,743
Accrued prize liabilities	30,291,269	24,918,706
Other accrued liabilities	<u>1,593,827</u>	<u>1,551,182</u>
Total current liabilities	41,922,305	35,215,104
OTHER DEFERRED LIABILITIES	5,094,585	5,600,362
RETAINED EARNINGS	<u>0</u>	<u>0</u>
Total liabilities and retained earnings	<u><u>\$ 47,016,890</u></u>	<u><u>\$ 40,815,466</u></u>

The accompanying notes are an integral part of these balance sheets.

MISSOURI LOTTERY

STATEMENTS OF REVENUES, EXPENDITURES AND RETAINED EARNINGS

FOR THE YEARS ENDED JUNE 30, 1998 AND 1997

	<u>1998</u>	<u>1997</u>
OPERATING REVENUES:		
On-line ticket sales	\$ 207,516,114	\$ 188,757,331
Instant ticket sales	257,643,316	222,342,990
Pull-tab ticket sales	<u>29,139,331</u>	<u>28,491,979</u>
Total operating revenues	<u>494,298,761</u>	<u>439,592,300</u>
OPERATING EXPENDITURES:		
On-line prize expense	104,469,294	95,393,749
Instant prize expense	150,357,042	128,488,183
Pull-tab prize expense	18,341,981	17,981,392
On-line retailer commissions and incentives	11,892,649	10,763,645
Instant retailer commissions and incentives	16,821,655	14,661,085
Pull-tab retailer commissions and incentives	2,396,317	2,325,782
Cost of tickets sold	12,457,684	10,805,208
Advertising and promotions	10,193,847	10,714,037
Wages and benefits	7,072,782	6,527,615
Other general and administrative	<u>11,901,186</u>	<u>10,605,205</u>
Total operating expenditures	<u>345,904,437</u>	<u>308,265,901</u>
Operating revenues over expenditures	<u>148,394,324</u>	<u>131,326,399</u>
NONOPERATING REVENUES:		
Interest income	945,708	1,045,038
Other	<u>185,404</u>	<u>292,490</u>
Total nonoperating revenues	<u>1,131,112</u>	<u>1,337,528</u>
Income before transfers	149,525,436	132,663,927
TRANSFERS TO STATE OF MISSOURI:		
Operating transfers	<u>(149,525,436)</u>	<u>(132,663,927)</u>
Excess of revenues over expenditures and transfers	0	0
RETAINED EARNINGS AT BEGINNING OF YEAR	<u>0</u>	<u>0</u>
RETAINED EARNINGS AT END OF YEAR	<u>\$ 0</u>	<u>\$ 0</u>

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 1998 AND 1997

	<u>1998</u>	<u>1997</u>
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Income before transfers	\$ 149,525,436	\$ 132,663,927
Adjustments to reconcile income before transfers to net cash provided by operating activities-		
Operating transfers	(147,134,560)	(134,201,860)
Depreciation	1,940,880	2,338,150
Gain on sale of assets	(99,780)	(160,647)
Grand prizes deferred	10,789,592	12,593,179
Transfers to Grand Prize Winners Trust Account	(10,789,592)	(12,593,179)
Change in assets and liabilities-		
Increase in accounts receivable	(2,987,692)	(2,312,973)
Decrease (increase) in ticket inventories	75,885	(257,061)
(Decrease) increase in accounts payable and other accrued liabilities	(1,562,015)	1,393,025
Increase (decrease) in accrued prize liabilities	5,372,563	(2,015,360)
Net cash provided by (used in) operating activities	<u>5,130,717</u>	<u>(2,552,799)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(1,318,831)	(2,279,919)
Proceeds from sale of assets	115,388	167,649
Net cash used for investment activities	<u>(1,203,443)</u>	<u>(2,112,270)</u>
Net increase (decrease) in cash	3,927,274	(4,665,069)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>15,281,454</u>	<u>19,946,523</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 19,208,728</u>	<u>\$ 15,281,454</u>

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

GRAND PRIZE WINNERS TRUST ACCOUNT

BALANCE SHEETS AS OF JUNE 30, 1998 AND 1997

	<u>1998</u>	<u>1997</u>
<u>ASSETS</u>		
U.S. GOVERNMENT SECURITIES	<u>\$ 104,311,279</u>	<u>\$ 96,944,238</u>
<u>LIABILITIES</u>		
DEFERRED GRAND PRIZE LIABILITY	<u>\$ 104,311,279</u>	<u>\$ 96,944,238</u>

MISSOURI LOTTERY

STATEMENT OF CHANGES IN GRAND PRIZE WINNERS TRUST ACCOUNT

FOR THE YEARS ENDED JUNE 30, 1998 AND 1997

	<u>1998</u>	<u>1997</u>
TRANSFERS FROM MISSOURI LOTTERY	\$ 10,789,592	\$ 12,593,179
INTEREST ACCRETION	7,169,449	6,541,157
PAYMENTS TO GRAND PRIZE WINNERS	<u>(10,592,000)</u>	<u>(9,372,000)</u>
Net increase	7,367,041	9,762,336
BALANCE AT BEGINNING OF YEAR	<u>96,944,238</u>	<u>87,181,902</u>
BALANCE AT END OF YEAR	<u>\$ 104,311,279</u>	<u>\$ 96,944,238</u>

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1998 AND 1997

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Missouri Lottery (the Lottery) is accounted for as a proprietary type enterprise fund, is a component unit of the State of Missouri and is exempt from income taxes. The financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting and conform with practices generally followed in the gaming industry.

Revenue Recognition

Sales of on-line lottery tickets are generated by the semiweekly "LOTTO" and "Powerball" games, and the daily "Show-Me 5", "Daily Millions" and "PICK 3" games. Sales of lottery tickets are made through licensed retail sales outlets via on-line terminals maintained by the retailers. Ticket sales are recognized at the time the player purchases a ticket from the retailer.

Sales of instant lottery tickets are made to licensed retail sales outlets with the right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player. Allowances have been established for estimated tickets to be returned by retailers of approximately \$366,000 and \$376,000 at June 30, 1998 and 1997, respectively.

Sales of pull-tab lottery tickets are made to licensed retail sales outlets with no right of return. Ticket sales are recognized upon the sale of tickets to retailers and are valued at the sale price to the player.

Prizes

Expenditures for on-line lottery ticket prizes are recorded based on a minimum of 45% of on-line lottery ticket sales. The minimum grand prize amount for the semiweekly "LOTTO" game is \$1,000,000. Grand prize winners have the choice of receiving the prize in 25 annual installments or a portion of the prize in one lump-sum payment. Any prize that remains unclaimed for one year from the date of the on-line game drawing is used to fund future prize pools.

Expenditures for instant lottery ticket and pull-tab lottery ticket prizes are recorded based upon the unique, predetermined prize structure for each game and are accrued as tickets are sold to the retailer.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and money market funds on deposit with the State Treasurer and banks. The cash on deposit with the State Treasurer is pooled with other Missouri state funds and is fully secured by the depository institutions holding the funds. The Lottery considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Retailer Fees

Licensed retailers are charged a fee for the right to sell lottery tickets. Additionally, certain retailers pay an annual fee in lieu of obtaining an insurance bond. Such fees are maintained in a reserve fund to offset uncollectable accounts receivable from retailers. This reserve fund approximated \$443,000 and \$493,000 at June 30, 1998 and 1997, respectively, and is reflected as a reduction of accounts receivable on the accompanying balance sheets.

Ticket Inventories

Ticket inventories consist of instant and pull-tab tickets purchased by the Lottery for new games which have not been implemented. Inventories are carried at cost, using the specific identification method. Tickets are charged to cost of tickets sold upon implementation of the game.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated life of the related asset. When assets are retired or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period.

Due to Lottery Proceeds Fund

All income before operating transfers of the Lottery, as described in the accompanying statements of revenues, expenditures and retained earnings, accrues to the benefit of the State of Missouri. Operating transfers are made to the Lottery Proceeds Fund, which shall be appropriated by the State solely for the institutions of elementary, secondary and higher education.

Operating transfers are made monthly and are based on estimated income before operating transfers. A portion of the liability to the Lottery Proceeds Fund, equal to the net book value of capital additions after September 1, 1988, is deferred and is not subject to current operating transfers.

2. STATUTORY REQUIREMENTS:

Missouri statutes provide that a minimum of 45% of the money received from the sale of lottery tickets shall be allocated to prizes. The costs of operating the Lottery, including all commissions to retailers, promotional costs, and all other administrative expenditures, are appropriated by the General Assembly of the State of Missouri.

The Lottery receives certain services for no charge from other Missouri state government agencies. Investigative services are provided by the Missouri State Highway Patrol. The Office of Administration provides certain services to process expenditures and payroll for the Lottery.

3. ON-LINE TICKET SALES:

On-line ticket sales consist of the following:

	<u>1998</u>	<u>1997</u>
Powerball	\$ 101,082,612	\$ 76,145,527
PICK 3	49,711,706	48,362,345
LOTTO	27,875,180	31,892,109
Show-Me 5	23,666,577	22,783,598
Daily Millions	<u>5,180,039</u>	<u>9,573,752</u>
	<u>\$ 207,516,114</u>	<u>\$ 188,757,331</u>

Grand prize winners of MUSL's games prior to November 5, 1997 receive prize payments annually over a 20-year period. Powerball grand prize winners after that date have the choice of receiving the prize in 25 annual installments or a portion of the prize in one lump-sum payment. Investment securities, with maturities that approximate all grand prize winner payments due to winners of MUSL games, are maintained by MUSL. The investments and related prize liabilities for winners of these games from the state of Missouri are excluded from the accompanying grand prize winners trust account statements. Future grand prize winner payments of MUSL games due to winners in Missouri are approximately \$262,418,000 as of June 30, 1998.

The Lottery has contributed to a prize reserve fund and set prize reserve fund, separately maintained by MUSL, to protect MUSL members in case of unforeseen liabilities and to pay certain prizes associated with Powerball, respectively. With certain restrictions, these fund balances are refundable to member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 1998, the Lottery's portion of the prize reserve fund and set prize reserve fund was approximately \$4,220,000 and \$1,615,000, respectively.

The Lottery has contributed to an account with MUSL which is used to pay certain operating expenses incurred by member lotteries for the Powerball and Daily Millions games. With certain restrictions, the balances in this account are refundable to the member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 1998, the Lottery's portion of the balance of this account was approximately \$953,000.

8. GRAND PRIZE WINNERS TRUST ACCOUNT:

Since March 1990, to fund future payments under grand prize winner prize claims, the Lottery purchases U.S. Treasury zero coupon bonds, with maturities approximating deferred grand prize annuity installment amounts and due dates. The securities purchased are held in the Lottery's name in safekeeping by the Federal Reserve Bank in a separate account for the grand prize winners trust account. The investments in these securities are carried at cost, adjusted for the accretion of discounts based on the purchase yield and the maturity date. Accretion on these investments is not recognized as revenue of the Lottery but is credited to deferred grand prize liability. These securities are not subject to trading and are intended to be held to maturity. The market value of these securities at June 30, 1998 and 1997, was approximately \$116,059,000 and \$102,033,000, respectively. The maturity value of securities held at June 30, 1998 and 1997, was \$169,801,000 and \$161,542,000, respectively.

Scheduled grand prize installment payments to be funded by the maturing U.S. Treasury zero coupon bonds, as of June 30, 1998, are as follows:

<u>Fiscal Year Ending</u>	<u>Amount</u>
June 30, 1999	\$ 11,541,000
June 30, 2000	11,541,000
June 30, 2001	11,541,000
June 30, 2002	11,541,000
June 30, 2003	11,541,000
Thereafter	<u>112,096,000</u>
Total installment payments due	169,801,000
Less- Interest portion	<u>65,489,721</u>
	<u><u>\$ 104,311,279</u></u>

Prior to March 1990, the Lottery purchased annuity contracts from selected insurance companies to fund the "LOTTO" grand prize claims. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, neither the value of the annuities nor the value of the related future payments are reflected in the accompanying financial statements. Future installment payments to be made to grand prize winners by these insurance companies totaled approximately \$63,662,000 at June 30, 1998.